Effect of Corporate Social Responsibility on Profitability of Banks

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Abstract:

This study shed light on the effect of Corporate Social Responsibility, size, income variability, and firm growth on the profitability of banking firms. Panel data from 2006-17 of the variables have been collected from the financial reports of the selected. CSR, growth and size of firm have positive & significant effect on Return on equity and income variability have negative effect on Return on equity and return on assets. All variables have positive effect on Earning per share but income variability have negative effect on Earning per share. It is recommended that business organizations should formulate financial policies for dominating their financial position not only for the sake of profitability but also for implementing CSR strategies so that the objectives all stakeholders may be protected.

Key words: CSR, EPS, ROA, ROE, Profitability

I.   INTRODUCTION

Corporate Social Responsibility generally pronounces obligations of the firm in order to protect and improve social welfare in present as well as in the future, by creating sustainable welfares for stakeholders (Lin et al., 2009).

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Corporate Social Responsibility is the most important and strategic part for every business organization in decision making, that how they improve and enhance productivity of the business through CSR's activities. (Srivastava, 2012). Executives may expand competitiveness by adopting CSR strategies, based on the strengths of their corporations. (Nagurney & Li, 2014). CSR has become a progressively significant part for companies' tasks (Deng, Kang, &Low, 2013). Corporate social responsibility (CSR) is a dynamic and modest strategy for business organizations. (Chandler &Werther, 2013). Policies employed by business concerns to conduct their business activities in such a way that is decent, civilized and beneficial to community in terms of development is known as Corporate social responsibility, (Ismail, 2009). Some corporations enhance their investment in corporate social responsibility while some firm's only show large part of their capital to present CSR activities in their annual reports. (Flammer, 2013).

In the year 1950 the concept of corporate social responsibility was introduced as corporate responsibility and Howard Bowen was the first author who published a book in 1953 on corporate social responsibility. In this modern era the strategy of CSR is an integral part of business for many organizations for addressing the environmental and social impact of company activities (Luo and Bhattacharya, 2006; Lin et al., 2009; Dabas, 2011; Beret, 2011). Although most of the corporations or firms adopt CSR policies while some of consider environment and society to be the smaller domain with the economy. (Berete, 2011). Studies show that the more the companies are socially responsible the larger the companies are profitable. (Moore, 2001). An essay written by Milton Friedman in 1970s in New York Times about the importance of CSR in private firms for the creation of value of shareholders in the corporations. This idea was not only used but widely

appreciated all over the world and also proved to be correct.. (Harjoto, 2011)

The last decades have observed melodramatic variations in the associations between the public, private sector and civil society. Nowadays a new idea termed as corporate social responsibility (CSR) has introduced and the primary objective of this activity is usually adopted by business in order to satisfy the needs of stakeholders engaged in cycle of business operations. (Ajala, 2005). In this modern age of business every firm and corporation examine their goodwill on the basis of social, economic, and ordinary principles. There are many debates, conflicts and contradictory views among the scholars and researchers on CSR that it helps the firms in many areas and also improve the productivity and profitability. However according to some there exists negative correlation in corporate social responsibility and firm's profit. The ability of a business or corporation to earn positive profit is termed as profitability or productivity. In this modern age of business most of the organizations paying attention on CSR because the business operate in the society and society demand some social responsibilities i.e contribution in the welfare of the society from the corporations or business organizations. The CSR is not an old topic for some countries because in Pakistan all kind of business organizations use it in the present world competition. (Islam, 2009).

Revenue is the primary objective for all kind of business organizations because it is the basic component for the survival, development and long life of a business firm. All kind of business organizations and corporations have been confronted, not only by the major progressions that happened at the end of the twentieth century, such as privatization, deregulation and globalization, but also by expectations of the society from the firms regarding contributions to public welfare and social involvement. Slowly, large corporations have started to adopt the strategy of CSR processes, such as public commitments to

comply with standards, fostering stakeholder involvement community investments & conforming, systematic public reporting on environmental and social performance. Corporate Social Responsibility strategy has grown beyond, both practically and theoretically, money donations, the area of philanthropy and charity actions. CSR has become a dynamic approach to embrace the interests of stakeholders, a way to retain the modest advantage and to settle profit objectives with long-term policies. The natural value was that CSR has become an object of political actions, public debates and research study, but also a substance of supremacy in most regional and global organizations of most of the countries. Return on equity and Return on Assets are accounting ratios & most famous measurement which are usually used by researcher that how effectively and efficiently management use the assets and equities of corporations for enhancing turnover and corporations sales to maximize productivity level. (Raza et al., 2012).

The aim of the research is to analyze proxy variables for banking firms in Pakistan and the effect of Corporate Social Responsibility on the profitability of banking firms in Pakistan.

II.   REVIEW OF LITERATURE

Literature is available on the topic of CSR and its relation with profitability of corporations; effect of corporate social responsibility on profitability of banking firm, corporations and businesses of various countries of the world. The literature regarding CSR is rich with hundreds of research studies, exploring the relationship among business, financial performance, profitability and social activities of the corporations y (e.g. Griffin and Mahon, 1997; Waddock and Graves, 1997; Jackson and Parsa, 2009; Kempf and Osthoff, 2007). But according to quantitative research studies it is concluded that there are unsettled proofs of the relationship

between profitability and CSR. Published Important published literature on the topic of CSR and profitability of business organizations is summarized as under:

Aupperle et al. (1985) state in their study that there is negative relation among profitability, productivity, financial performance of corporation or business organization and CSR activities. Further this research study states that by investing on CSR activities the cost of the those firms increase that are not socially responsive and also it is a financial burden and weak the position of business. The researchers Pava and Krausz (1996) conducted research study by examining about twenty one research studies on CSR and Profitability between the year 1972s and 1992s. The results of twelve studies showed positive relation 8 showed no relation and 1 study showed inverse relationship among CSR and financial performance.

Waddock and Graves (1997) measure the profitability of corporate financial performance by using three measures which are ROA, ROE, and ROS and other numerous procedures for measuring profitability of corporations for the business stakeholders. Business organization with good financial position can invest in long term project by investing or building education institute for the welfare of the society while firm having weak financial position will adopt traditional CSR activities. Carroll (1999) conducted research study on the topic of CSR wherein he concluded that the term CSR is social responsibility of the firm. Many people have defined CSR according to their own research and concepts but the most citied and accurate definition is given by Carroll (1979) "the social responsibility of firms involves the ethical, economic, legal and discretionary hopes that society has of organizations at the any given point in time'. He further states that firm carried these responsibilities for the sake of both the firm at large and the society. So, firms are indebted to take the interest of the society into consideration when taking its verdict because at last the society is greatly pretentious by those verdicts.

Different economists and researchers worked on this topic and give their views which are different from each other. Conflict over CSR exists among different researcher and scholars from the year 1950s. A researcher of UK, Moore (2001) conducted research study on the topic of CSR, profitability and productivity, by investigating the association among these components. The results of his study showed negative relation among the productivity, profitability and CSR activities of supermarket industry in UK. However according to another researchers, Mc Williams and Siegel (2001) states in their study that there is no significant relation among corporate performance and CSR activities.

According to the research study results of " (Wild et al, 2005) the good performance of the business totally depends on its maximum return on assets. It reflects the stable position of the company and attract investors. The ability of the company to meet its liabilities of short term period is usually calculated through liquidity ratio. However performance of the managers that how efficiently they use or manage assets measured through asset management ratio. (Brigham and Houston, 2001) while the ability of firms to manage its long period obligations measured through Debt Management Ratio. According to Van de Ven and Graafland (2006) stated in his study that CSR has positive effect on the profitability of the corporations. According to the study of Peloza and Papania (2008) the profitability aspect of different organizations belong to dissimilar industry may different in CSR effect and it also depends that how much level of significance allotted to each main stakeholders for the industry.

Inoue and Lee (2011) conducted study in order to know that how different extents of CSR activities could affect financial performance of firms within 4 similar tourism industries. The results of their study showed that financial impact different across these four same tourism industries. According to Godfrey et al. (2009) that if management of

corporation adopt both CSR and profitability strategy then CSR and financial performance will be perfect. According to a study conducted by Abdullah (2014) on stock exchange of Pakistan for the purpose to know about the effect of investment in CSR and its relation with profitability of the firm. In this study the author took the data of 20 companies out of which half were practicing investment in CSR and the remaining were not engaged in the said activities. After analyzing the data the results of the study showed that those firms which were engaged in the practicing of investment in social welfare of the workers or stakeholders and CSR were financially strong and earned maximum profit as compared to the firm which were not engaged in such practices.

According to a study conducted by Rahmawati (2014) on Indonesian stock market for ascertaining the association among CSR and investment activities and its effect on firms maximizing profit activities. In this study he analyzed 27 organizations data for the year 2006-2008 and concluded that there is direct association of CSR with financial performance, competitive edge and market share of corporations. Shruti (2014) conducted research for the purpose to know the association among the CSR, investment and profitability of the firms. Author conducted this research on UK's three industries by taking data from 2008-12 of ROA and ROE for calculating financial performance and profitability of these industries i.e. Petroleum, Gas and extraction industry. In this study the author concluded that CSR, Investment, Financial performance have significant effect.

Raza et al. Used the quantitative data for analysis from the year 1972 to 2012. In this study they select Stock market return, Return on equity (ROE), Return on asset (ROA), Earning per share (EPS) and Return on sale for their analysis. Result of their study showed that these accounting ratios are very perfect for ascertaining the profitability of the firms and

almost all researchers rely on these accounting ratios i.e. EPS, ROA, ROE and ROS for their analysis.

III.   RESEARCH METHODOLOGY

This section of our paper discuss about the Dependent, independent, control variables, population, sample, sampling technique, data collection, different tests, statistical software and model of the study.

3.1   Population, size, Data and sampling technique.

The study population consists the following 8 banks operating in Pakistan. Askari Bank, MCB bank, United Bank, Bank Alfalah, Habib Bank, Allied Bank, Faysal Bank and Bank Al-Habib. Data is collected from the annual reports available on the official website of these banks as well State Bank of Pakistan. In this research study we have used data of 12 years from 2006-2017, in this research study we have used non probability sampling technique.

3.2   VARIABLES FOR THE STUDY

We have used three kinds of variables in our research paper.

1.   Independent variables
2.   Dependent variables
3.   Control variables.

3.3   INDEPENDENT VARIABLE

In this research paper Corporate Social Responsibility is taken as Independent variable because it is not dependent on any other variable in this research study.

3.3.1   MEASURING   CORPORATE   SOCIAL RESPONSIBILITY (CSR)

Basically there are two proxies which are mostly adopted by researcher for the measurement of Corporate Social

Responsibility i.e donations and money spent on for the welfare of the firm's workers. Coffey & Fryxell and 1991, Lin, et al., 2009. In many research study it has analyzed that most of the organizations consumer their millions amount on the charitable activities which indicates that donation is used as a proxy for the measurement of CSR. Compensation to workers in the firms is also used as proxy for CSR. (Muller & Kolk, 2008). In most of the research work the researchers have used these proxies for measuring CSR. We will also use these as proxy for CSR in our research study. (Cox et al, 2004 Scholtens, 2008, and Muller & Kolk, 2008) CSR = Donation + Worker's welfare funds / Earning before tax.

3.4   DEPENDENT VARIABLES

In our this research study we have taken Earing per share (EPS), Return on Asset (ROA) and Return on Equity (ROE) as our dependent variables which are accounting ratio, usually used by researchers and chartered accountants for calculation of profitability of the firms.

3.5   CONTROL VARIABLES

In this research study we have taken income Variability, Size of Firm and Expected Growth rate our control variables.

3.6 SIZE OF COMMERCIAL BANKS

Large type of business organization and firm usually can safe their organization from losses due to their policies and according to the static trade off hypothesis an organization would be more diversified if the size of such organization is large and it will be in a position to protect itself against loss in some cases. Numerous techniques are adopted by the researcher for the calculation of firm size one of the most important procedure is total number of employees and total assets and natural log of the firm's total assets.

$$Size = Log\ total\ assets$$

3.7 EXPECTED GROWTH

The growth of the firms can be calculated as growth is equal to current year total assets divided by previous year total assets multiply with one hundred. Growth is very important component for all type of organization because the firm size depends on its annual growth. The famous formula for calculating growth is as follows.

$$\text{Growth} = \frac{\text{total assets of current year}}{\text{total assets of previous year}} \times 100$$

3.8 INCOME VARIABILITY

It effect the profitability of firm and used for measuring risk as bankruptcy increase. It can be calculated as under. (Erica et al., 2011)

$$\text{Income variability} = \frac{\text{STDEV of EBIT}}{\text{Total Assets}}$$

3.9 MODEL FOR THE STUDY

In our this research study profitability is dependent variable for which ROA, ROE and EPS have used as proxy dependent variables, CSR is independent variable while Growth, Size and income variability has used as control variable in this research study . The below model is developed for this study.

$ROA_{it} = \propto + \beta 0 CSR_{it} + \beta 1\ SF_{it} + \beta 2\ EG_{it} + \beta 3\ InV_{it} + \varepsilon$

$ROE_{it} = \propto + \beta 0 CSR_{it} + \beta 1\ SF_{it} + \beta 2\ EG_{it} + \beta 3\ InV_{it} + \varepsilon$

$EPS_{it} = \propto + \beta 0 CSR_{it} + \beta 1\ SF_{it} + \beta 2\ EG_{it} + \beta 3 Inv_{it} + \varepsilon$

ROA= return on assets

ROE= return on equity

EPS= earnings per share

CSR= corporate social responsibility

SF= size of firm

EG= expected growth of firm

InV= income variability of firm

IV.   RESULTS AND DISCUSSION

In this section of our research paper we have analyzed the data regarding dependent, independent and control variables through statistical software. The results of descriptive statistics, chow test, Hausman test and Breusch Pagan LM are interpreted below in details:-

4.1   DESCRIPTIVE STATISTICS

Variables	Observations	Mean	Std Deviation	Minimum	Maximum
ROE	96	36.37	7.65	18.45	24.9
ROA	96	4.76	3.77	0.6	6.95
EPSRS	96	9.94	4.56	3.07	22.08
SIZE	96	9.08	4.77	15	26
Expected Growth	96	110.18	27.33	1.66	130.10
Income	96	0.0214	0.006	0.324	0.432
CSR	96	2.36	8.89	4.86	126.44

According to the results of descriptive statistics there are 96 observations for every variable. The mean value for ROE is 36.37, standard deviation value 7.65, minimum value 18.45 & maximum value 24.9. The mean value of ROA is 4.76, SD 3.77, minimum value 0.6 and maximum value 6.95. Mean value for EPS is 9.94, SD 4.56, minimum value 3.07 and maximum value 22.08. Size of firm's mean value 9.08, SD 4.77, minimum value 15 & maximum value26. Expected growth of firm has a mean value of 110.18, SD 27.33, minimum value 1.66 and maximum value 130.10. Income variability mean value is 0.0214, SD 0.006, minimum value 0.324 and maximum value of 0.432 and CSR mean value 2.36,SD 8.89, minimum value 4.86 and maximum value 126.44

TABLE 4.2 MODEL FOR ROA

Test	Null hypothesis	Alternate Hypothesis	P value
Chow	Pooled OLS is better than FEM	FE Model is better than Pooled OLS	4438
BP	Pooled OLS is better than RE Model	RE Model is better than Pooled OLS	0.5378
Hausman	REM is better than FEM	FE Model is better than RE Model	0.1968

4.2.1   MODEL SELECTION FOR ROA

4.2.1.1 CHOW TEST FOR ROA
The main objective of this test to select best model between FEM and pooled OLS. The P value is .4438 which states that pooled OLS is better than FEM.

4.2.1.2 BREUSCH PAGAN LM TEST FOR ROA
This test is used for selection between random effect model and pooled regression and random effect model. The p value is 0.5378 which is greater than 0.05. Therefore pooled OLS is better model.

4.2.1.3 HAUSSMANN TEST FOR ROA
The Haussmann test is used to select an appropriate model between random and fixed effect model. The p value is 0.1968 which is greater than 0.05 which states that random effect model is better for this study.

TABLE 4.3   MODEL FOR ROE

Test	Null Hypothesis	Alternate Hypothesis	P value
Chow	PooledOLS is better than FEModel	FEModel is better than PooledOLS	0.0482
BP	PooledOLS is better than REModel	REModel is better than PooledOLS	0.0357
Hausman	REModel is better than FEModel	FEModel is better than REModel	0.3640

4.3.1   CHOW TEST FOR ROE
The main objective of this test is to decide whether to select OLS or FEM. The P value is 0.0482 which is less than 0.05 so fixed effect model is better for this study.

4.3.1.1   Breusch and Pagan LM Test for ROE
This test is used for selection between OLS and random effect model. The P value is 0.0357 which is less than 0.05 so random

effect model is appropriate model than pooled regression model for this study.

4.3.1.2 HAUSSMANN TEST FOR ROE

This test is usually use to select between Fixed effect model or Random Effect Model. The P value is 0.3640which is greater than 0.05 so random effect model is better than FEM for this study.

TABLE 4.4   MODEL FOR EPS

Test	Null hypothesis	Alternate Hypothesis	P value
Chow	Pooled OLS is better than Fixed EM	Fixed EM is better than Pooled OLS	00.0287
BP	Pooled OLS is better than REM	REM is better than Pooled OLS	0.0473
Hausmann	Random EM is better than Fixed EM	Fixed EM is better than Random EM	0.6630

4.4.1   CHOW TEST FOR EPS

Chow test for EPS shows the P value 0.0287 which is less than 0.05 so Fixed Effect Model is better than Pooled OLS..

4.4.1.2 BREUSCH PAGAN LM TEST FOR EPS

This test is used to select between random effect model and pooled regression. The P value is 0.0473which is less than 0.05 so REM is better than pooled regression model.

4.4.1.3 HAUSMAN TEST FOR EPS

This test is used to select between FEM and REM. The P value is 0.6630which is greater than 0.05 so random effect model is better than FEM for this study.

TABLE 4.5   FOR MULTI CO LINEARITY

Variables	VIF
Size	1.34
CSR	1.32
Income	1.31
Expected Growth	1.37
Mean VIF	1.56

The value of all the explanatory variables VIF is less than 10 which states that there is no multi co-linearity problem in the data of this research study because variance inflation factor (VIF) is very important tool for decision.

TABLE 4.6   SHOWS RANDOM EFFECT RESULTS FOR ROE

Variables	Coefficients	Standard Error	T value	P value
Size	0.86	0.41	2.24	0.0457
Expected Growth	0.78	0.12	7.06	0.000
Income Variability	-0.61	0.34	-1.82	0.052
CSR	0.91	0.21	4.4	0.021
Constant	16.23	17.12	0.92	0.333

4.6.1   RANDOM EFFECT MODEL FOR ROE

4.6.1.2 COEFFICIENTS

The table of Random Effect Model for ROE shows that size, expected growth and CSR of firm have positive relation with ROE and the other variables have negative relations with ROE. The coefficient in the table indicates that one unit change in size will change ROE by 0.86 units positively and the coefficient of one unit increase in expected growth will increase ROE by 0.78 units. However income variability have negative relation with ROE. The results of our study are in line with the results of Basu, (2008) and also a similar results have s been drawn by Harmony J. Palmer (2012). From the above results it is concluded that CSR, growth and size of firm have significant effect on ROE.

TABLE 4.7 POOLED OLS MODEL FOR ROA

Variables	Coefficients	Standard Error	T value	P value
Size	0.403	0.23	2.44	0.049
Expected Growth	0.44	0.87	0.43	0.754
Income Variability	-3.54	2.66	-1.6	0.132
CSR	0.43	0.20	2.6	0.047
Constant	-5.44	3.43	-1.29	0.321

The results of pooled OLS for ROA shows that CSR, size and growth of firm have positive relation with ROA while income variability have negative effect on ROA. CSR and Size of firm

have significant effect on ROA while other variables have insignificant effect on ROA. The results of this study are same with the results of Basu, (2008).

TABLE 4.8   RANDOM EFFECT MODEL FOR EPS

Variables	Coefficients	Standard Error	T value	P value
Size	0.82	0.44	2.67	0.065
Expected Growth	0.84	0.44	3.77	0.034
Income Variability	-0.59	0.51	-1.6	0.747
CSR	0.55	0.34	3.7	0.045
Constant	0.81	0.70	1.54	0.448

According to random effect model for EPS all variables have positive effect on EPS but income variability of firm have negative effect on EPS. Furthermore according to this table results CSR, growth and size have significant effect on EPS at 5 %. The result of this study is in line with the previous results of basu, (2008) & Harmony J. Palmer (2012).

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This research paper investigated about the association among CSR, Size of firm, income variability, expected growth earning and Performance of the selected commercial banking firms. ROA, ROE and EPS are used as proxies of the performance of firms in this study. ROA, ROE and EPS are used as dependent while CSR as independent variable while Size of firm, income variability and expected growth earnings are used as control variables in this study. Data from 2006-2017 was collected from the websites of the selected firms and state bank CSR, growth and size of firm have positive & significant effect on ROE and income variability have negative effect on ROE and ROA. All variables have positive effect on Earing Per Share but expected income variability of firms have negative effect on EPS.

        The Policy makers of the business organizations should implement CSR strategy both for the sake of organization as

well as for the welfare of the society. The firm should also increase its level of productivity and profitability through CSR strategies so that the all kind of stakeholder may be protected from social as well as financial loss.

This study also suggest that firms mainly working on large scale or corporations should pay attention & should maintain proper head in their budget for the CSR so that the strategies of the said may be implement easily.

It is recommended that business organizations should formulate financial policies for dominating their financial position not only for the sake of profitability & strategic objective but also giving improvement to environment, society and all stakeholders by investing in CSR practices.

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